STATUTORY INSTRUMENTS

2004 No. 2199

INCOME TAX
TAXES

The Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004

Made - - - -	*27th August 2004*
Laid before the House of Commons - - - -	*27th August 2004*
Coming into force - -	*17th September 2004*

The Treasury, in exercise of the powers conferred upon them by paragraphs 2 to 5, 7 to 9, 11 and 16 of Schedule 33 to the Finance Act 2002(**1**), hereby make the following Regulations:

Citation, commencement and effect

1.—(1) These Regulations may be cited as the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004 and shall come into force on 17th September 2004.

(2) These Regulations have effect as follows –

(a) regulations 3 to 8 have effect in relation to any VCT-in-liquidation whose winding-up commences on or after 17th April 2002;

(b) regulations 9 to 13 have effect in relation to any merger where the transactions for effecting the merger take place on or after 17th April 2002; and

(c) regulation 14 has effect in relation to shares issued on or after 6th April 2004.

Interpretation

2.—(1) In these Regulations unless the context otherwise requires–

"the Board" means the Commissioners of Inland Revenue;

"eligible shares" has the meaning in Part 1 of Schedule 15B(**2**);

"the 15% test" means the condition specified in section 842AA(2)(d)(**3**);

(**1**) 2002 c. 23.
(**2**) 1988 c. 1; Schedule 15B was inserted by section 71(2) of the Finance Act 1995 (c. 4).
(**3**) Section 842AA was inserted by section 70(1) of the Finance Act 1995; there are no relevant amendments.

"market value" shall be construed in accordance with sections 272 and 273 of the 1992 Act;

"merger" of two or more companies (and the associated definitions of "the merging companies" and "the successor company") shall bear the appropriate meanings given by paragraph 10 of Schedule 33;

"the 1992 Act" means the Taxation of Chargeable Gains Act 1992(**4**);

"prescribed winding-up period", in relation to a VCT-in-liquidation, means the period –

(a) beginning on the commencement of the company's winding up, and

(b) ending on the earliest of –

(i) the end of the company's winding up,

(ii) the company ceasing to be wound up,

(iii) the dissolution of the company, and

(iv) the third anniversary of the commencement of the winding up;

"qualifying holdings" has the meaning in Schedule 28B(**5**);

"Schedule 33" means Schedule 33 to the Finance Act 2002;

"securities", except in regulation 12, has the same meaning as in section 842AA(12);

"the 70% test" means the condition specified in section 842AA(2)(b);

"the 30% test" means the condition specified in section 842AA(2)(c);

"statement of affairs" means a statement as to the affairs of a company, in the form prescribed under and complying with section 99 or 131 of the Insolvency Act 1986(**6**), as the case may be;

"the Taxes Act" means the Income and Corporation Taxes Act 1988(**7**);

"VCT approval" has the meaning given by paragraph 7(4) of Schedule 33, and any reference to such approval taking effect shall have the same meaning as in section 842AA;

"VCT-in-liquidation" has the meaning given by paragraph 1(1) of Schedule 33;

"venture capital trust" has the meaning given by section 842AA(1).

(2) In regulations 9 to 14 and this paragraph—

a "paragraph 10(1) merger" means a merger described in paragraph 10(1) of Schedule 33;

a "paragraph 10(2) merger" means a merger described in paragraph 10(2) of Schedule 33;

"share for business transfer" means an issue of shares as mentioned in paragraph 10(1)(b) or (2)(b) of Schedule 33 (in each case, omitting sub-paragraph (i) and the word "or" which follows it);

"share for share exchange" means an exchange of shares for shares as mentioned in paragraph 10(1)(b) or (2)(b) of Schedule 33 (in each case, omitting sub-paragraph (ii) and the word "or" which follows sub-paragraph (i));

"shares issued to effect the merger"—

(a) in the case of a paragraph 10(1) merger, means shares in the successor company issued as mentioned in paragraph 10(1)(b) of Schedule 33, and

(b) in the case of a paragraph 10(2) merger, means shares in the successor company issued as mentioned in paragraph 10(2)(b) of Schedule 33;

(**4**) 1992 c. 1.
(**5**) Schedule 28B was inserted by section 70(2) of the Finance Act 1995.
(**6**) 1986 c. 45.
(**7**) 1988 c. 1.

"shares issued for new consideration" means shares in the successor company, issued in the period during which the merger takes place, for a consideration other than as mentioned in paragraph 10(1)(b) or (2)(b) of Schedule 33.

(3) References in these Regulations to a section or Schedule (excepting Schedule 33), without more, are to that section of or Schedule to the Taxes Act.

(4) Paragraph 7(5) of Schedule 33 (acts of a liquidator attributed to the company) shall apply for the purposes of regulations 3 to 8 as it applies to Part 1 of Schedule 33.

(5) References to a resolution passed, or petition presented, to wind up a company (or other references to insolvency procedure) shall, where the winding up is wholly or partly other than under the law of England and Wales, include references to the corresponding local equivalents.

Winding up of Venture Capital Trusts

3.—(1) Regulations 4 to 8 apply, subject to paragraphs (2) and (3), in the case of a VCT-in-liquidation –

(a) whose VCT approval has had effect for the continuous period of 3 years immediately preceding the commencement of its winding up, or

(b) which is being wound up by the court under section 122(1) of the Insolvency Act 1986 (other than under paragraph (a) of that provision) or under any corresponding local equivalent,

and which has given notice to the Board that a resolution has been passed, or a petition presented, to wind up the company, pursuant to regulation 8(1) of the Venture Capital Trust Regulations 1995(**8**).

(2) Where a company—

(a) on or after 6th April 2004 and before 6th April 2006, makes an issue of shares falling within the circumstances in section 842AA(5A)(a) and (b)(**9**) (that is, whether or not the company makes a further issue as mentioned in paragraph (c) of that provision), and

(b) has not made an issue of shares falling within those circumstances, before 6th April 2004,

the period in paragraph (1)(a) shall be 5 years.

(3) Paragraph (1) shall not apply to any VCT-in-liquidation which is, or has at any time been, a merging company (other than a successor company).

4. For the purposes of paragraph 3(9) of Schedule 15B, the commencement of the winding up shall not affect the status of the VCT-in-liquidation as a venture capital trust.

5. Section 100(1) of the 1992 Act(**10**) (read with section 16(2) of that Act as regards losses) shall have effect as if a VCT-in-liquidation that would not otherwise be a venture capital trust were treated as a venture capital trust, during its prescribed winding-up period, in relation to gains and losses accruing on the disposal of assets acquired by the trust company before the commencement of its winding up.

6.—(1) Sections 151A(**11**) (excepting subsection (3)) and 151B(**11**) of the 1992 Act shall have effect as follows.

(2) During the VCT-in-liquidation's prescribed winding-up period those provisions shall have effect as if–

(**8**) S.I. 1995/1979.
(**9**) Subsection (5A) was inserted by section 75 of the Finance Act 1997 (c. 16), and amended by Paragraph 13 of Schedule 33 to the Finance Act 2002.
(**10**) 1992 c. 8; section 100(1) was amended by section 72(2) of the Finance Act 1995.
(**11**) Sections 151A and 151B were inserted by section 72(3) of the Finance Act 1995.
(**11**) Sections 151A and 151B were inserted by section 72(3) of the Finance Act 1995.

(a) the conditions in section 842AA(2) were fulfilled, and

(b) the VCT-in-liquidation, if not otherwise a venture capital trust, were so treated.

(3) At the end of the prescribed winding-up period, if–

(a) the VCT-in-liquidation is still in existence, and

(b) the conditions in section 842AA(2) are not fulfilled immediately following the end of that period,

VCT approval shall be treated, for the purposes of sections 151A(1) and 151B(6) and (7), as having been withdrawn from the VCT-in-liquidation immediately following the end of that period.

7.—(1) Paragraph 3(1) of Schedule 5C to the 1992 Act(**12**) ("paragraph 3(1)") shall have effect as if—

(a) the VCT-in-liquidation, if not otherwise a venture capital trust, were so treated during its prescribed winding-up period;

(b) during its prescribed winding-up period, paragraph (f) of paragraph 3(1) were omitted;

(c) in paragraph (g) of paragraph 3(1), for "(f)" there were substituted "(e)"; and

(d) there were added at the end of paragraph 3(1)—

"or

(h) a VCT-in-liquidation—

(i) to which regulation 7 of the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004 applies, and

(ii) in which those shares are shares,

is still in existence immediately following the end of its prescribed winding-up period (within the meaning in those Regulations).".

(2) Paragraph 3(6) of that Schedule shall be modified as if for "(f)" there were substituted "(h)".

(3) Paragraph 5(1) of that Schedule shall be modified as if for paragraph (d) there were substituted—

"(d) to the person who holds the shares in question immediately following the end of the company's prescribed winding-up period (within the meaning in the Venture Capital Trust (Winding up and Mergers) (Tax) Regulations 2004),".

Transfer of investments in specie from a VCT-in-liquidation to a venture capital trust

8.—(1) This regulation applies where –

(a) a VCT-in-liquidation has made all reasonable endeavours to sell shares or securities comprised in its qualifying holdings at, or as near as may be to, their market value, but has been unable to do so;

(b) the VCT-in-liquidation, during its prescribed winding-up period, transfers the shares or securities to a venture capital trust by way of a bargain made at arm's length, or for a consideration not less than their market value; and

(c) the value of all shares or securities transferred under this regulation by the VCT-in-liquidation to venture capital trusts during its prescribed winding-up period does not exceed 7.5% of the aggregate value of the investments of the VCT-in-liquidation at the commencement of its winding up.

(**12**) Schedule 5C was inserted by section 72(4) of the Finance Act 1995.

(2) For the purposes of paragraph (1)(c) the value of investments (including shares or securities) shall be taken to be –

(a) those used in the VCT-in-liquidation's statement of affairs, or

(b) where sub-paragraph (a) does not provide a value for the investment, its market value at the commencement of the winding up.

(3) Where the requirements of any of paragraphs 1(2)(b) and 6 to 8 of Schedule 28B were satisfied (or deemed to be satisfied) to any extent or for any period in relation to the investment when held by the VCT-in-liquidation (whether before or after the commencement of its winding up), they shall be treated as satisfied to the same extent or for the same period in relation to the investment when held by the venture capital trust.

Mergers of Venture Capital Trusts

9.—(1) Regulations 11 to 13 shall apply to a merger of two or more companies, each of which was a venture capital trust immediately before the merger begins to be effected, in any case where, before the transactions for effecting the merger take place, the Board have notified their approval of the merger, subject to paragraph (2).

(2) In the case of a paragraph 10(2) merger, the approval of the merger (and the application of regulations 11 to 13) shall be conditional on the successor company having VCT approval, and on the VCT approval having taken effect, at any relevant time for the purposes of those regulations (excepting regulation 13(4)(a)).

(3) The Board shall not approve the merger unless, on the application of a merging company or a successor company, the Board are satisfied that –

(a) the merger is effected for bona fide commercial reasons and is not part of a scheme or arrangement the main purpose of which, or one of the main purposes of which, is the avoidance of tax;

(b) in the case of a paragraph 10(2) merger, that the shares issued to effect the merger will be issued only at times when there are no issued shares in the successor company, other than subscriber shares, such shares as may be required to obtain a trading certificate under section 117 of the Companies Act 1985(**13**) and shares previously issued to effect the merger;

(c) where there is a share for share exchange, more than 50% of the issued share capital, immediately before the transactions for effecting the merger, of—

(i) each of the other merging companies (in a paragraph 10(1) merger), or

(ii) each of the merging companies (in a paragraph 10(2) merger),

(or shares representing them) will be exchanged for shares issued to effect the merger;

(d) where any consideration other than shares in the successor company is offered to—

(i) all or any members of another merging company (in a paragraph 10(1) merger), or

(ii) all or any members of a merging company (in a paragraph 10(2) merger),

in exchange for their holdings in that company, the amount or value of such consideration does not exceed 10% of the aggregate amount or value of consideration offered to the members of that company;

(e) where there is a share for business transfer, the shares are issued in respect of and in proportion to (or as nearly as may be in proportion to) the holdings of the persons to whom they are issued in the other merging company or companies (in a paragraph 10(1) merger) or merging companies (in a paragraph 10(2) merger);

(**13**) 1985 c. 6.

(f) where there is a transfer of part of the business of a merging company to the successor company as mentioned in paragraph 10(1)(b)(ii) or 10(2)(b)(ii) of Schedule 33, the market value of the part not so transferred is merely incidental in comparison with the market value of the part so transferred; and

(g) the money raised by any shares issued for new consideration (or any assets directly or indirectly derived from that money) to be used for the purpose of the successor company purchasing its own shares, or those of any of the merging companies, shall not exceed the least of A, B and C,

where:

A equals 20% of the amount of money raised by the shares issued for new consideration (or of the aggregate of those amounts if there has been more than one such share issue);

B equals 5% of the aggregate of all amounts subscribed for eligible shares issued before the merger in—

(i) the successor company, and

(ii) the merging companies, or other merging companies, as the case may be; and

C equals £3,000,000.

Procedure for Board's approval

10.—(1) Any application under regulation 9(3) shall be in writing and shall contain particulars of the transactions in connection with the merger that are to be effected and the Board may, within 30 days of the receipt of the application or of any further particulars previously required under this paragraph, by notice require the applicant to furnish further particulars for the purposes of enabling the Board to make their decision; and if any such notice is not complied with within 30 days or such longer period as the Board may allow, the Board need not proceed further on the application.

(2) The Board shall notify their decision to the applicant within 30 days of receiving the application or, if they give a notice under paragraph (1), within 30 days of the notice being complied with.

(3) If the Board notify the applicant that they are not satisfied as mentioned in regulation 9(3) or do not notify their decision to the applicant within the time required by paragraph (2), the applicant may within 30 days of the notification or of that time require the Board to transmit the application, together with any notice given and further particulars furnished under paragraph (1), to the Special Commissioners, and in that event any notification of approval by the Special Commissioners shall have effect for the purposes of these Regulations as if it were a notification of approval by the Board.

(4) If any particulars provided under this regulation do not fully and accurately disclose all facts and circumstances (including any change in circumstances) material for the decision of the Board or the Special Commissioners then, unless the applicant shows that the information in question was not in his possession or power, any resulting notification of approval by the Board or Commissioners shall be void.

(5) The Board may supply to any joint applicant –

(a) any information relating to the application, to a decision made on the application or to any change in circumstances relevant to the application or a decision; and

(b) any communication made or received relating to the application, decision or any change in circumstances.

11. An individual shall not be entitled to claim relief under Part 1 of Schedule 15B(**14**) in respect of any shares issued to him to effect the merger by the successor company, and they shall be disregarded in determining whether the permitted maximum for the purposes of that Schedule has been exceeded (but this regulation does not extend to shares issued for new consideration).

12.—(1) Where there has been a merger, the 70% test, the 30% test and (subject to regulation 13(6)) the 15% test, and the requirements of section 842AA(2)(a)(**15**) and Schedule 28B(**16**), shall apply to the successor company–

(a) as if the property of the merging companies were vested in the successor company (transfers between a merging company and the successor company being disregarded accordingly),

(b) disregarding, in the hands of the successor company, any assets that consist in rights against, or in shares or securities of, another company which is a merging company, and

(c) disregarding, in the hands of the successor company, the use of any money which, in the hands of another company which is a merging company, would have been disregarded under section 842AA(5B), for the same periods as are mentioned in that provision.

(2) Section 171(2)(cc)(**17**) of the Taxation of Chargeable Gains Act 1992 shall not apply to a disposal following a merger, where the disposal is—

(a) by a merging company to the successor company, and

(b) of an asset held by the merging company immediately before, or in the period during which, the merger takes place.

13.—(1) Where there has been a merger, the following paragraphs apply.

(2) The relevant shares issued to effect the merger are referred to as the "new shares" and—

(a) in the case of a share for share exchange, the corresponding shares for which they were exchanged, and

(b) in the case of a share for business transfer, the corresponding shares in respect of which they were issued,

are referred to as the "old shares".

(3) For the purposes of Schedule 15B, and of Schedule 5C(**18**) to the 1992 Act—

(a) any share for share exchange or share for business transfer shall not be treated as a disposal of the old shares, or as a chargeable event for the purposes of Schedule 5C to the 1992 Act,

(b) any other act (including the giving of relief under Part 1 of Schedule 15B, or under paragraph 2 of Schedule 5C to the 1992 Act) carried out, or failure to act, in relation to the old shares shall be treated as carried out, or omitted, in relation to the corresponding new shares, and

(c) references to the company in which the old shares were held shall be read as references to the successor company.

(4) For the purposes of sections 151A and 151B of the 1992 Act(**19**), where the successor company—

(a) was not a venture capital trust at the time when shares issued to effect the merger were acquired, but

(**14**) 1988 c. 1; Schedule 15B was inserted by section 71(2) of the Finance Act 1995 (c. 4).
(**15**) Section 842AA was inserted by section 70(1) of the Finance Act 1995; there are no relevant amendments.
(**16**) Schedule 28B was inserted by section 70(2) of the Finance Act 1995.
(**17**) 1992 c. 1; section 171(2)(cc) was inserted by section 135(1) of the Finance Act 1998 (c. 36).
(**18**) Schedule 5C was inserted by section 72(4) of the Finance Act 1995.
(**19**) Sections 151A and 151B were inserted by section 72(3) of the Finance Act 1995.

(b) is a venture capital trust at the time of a subsequent disposal of those shares,

it shall be treated as a venture capital trust at and from the former time.

(5) Where the requirements of any of the paragraphs of Schedule 28B (except paragraph 9) were satisfied (or deemed to be satisfied) to any extent or for any period, in relation to an investment when held by a merging company immediately before the merger, they shall be treated as satisfied to the same extent or for the same period, in relation to the investment when held by the successor company, as if the successor company and the other company were the same company.

(6) For the purposes of paragraph 9 of Schedule 28B and the 15% test—

(a) the period during which the merger takes place shall be disregarded, and

(b) if, as a result of the merger, the requirements of that paragraph or that test, as the case may be, would not be met immediately after the merger, those requirements shall be treated as met for a further period of one year.

(7) For the purposes of section 842AA(2)(b) to (d) the value of investments in the hands of the successor company immediately after the merger shall be their value when last valued before the merger, in accordance with subsection (5) of that section, unless there has been a transaction (other than the merger) whereby those investments would fall to be so revalued.

(8) For the purposes of paragraph 10B(**20**) of Schedule 28B the like provisions as are contained in paragraph (7) shall apply (substituting references to valuations in accordance with paragraph 10B for references to valuations in accordance with section 842AA(5)).

(9) Where—

(a) a merging company, other than a successor company, obtained VCT approval in exercise of the power conferred by section 842AA(4) (provisional approval), and

(b) the approval is withdrawn following the merger,

section 842AA shall apply to the withdrawal of approval with the modifications that, in subsection (7) the words "Subject to subsections (8) and (9)," and subsections (8) and (9), are omitted.

Limiting the operation of section 842AA(5B)

14.—(1) Section 842AA(5B)(**21**) shall apply to a further issue of shares (in the circumstances mentioned in subsection (5A) of that section) conditionally on the money being raised by that further issue for the purposes of investment (that is, for the purpose of the trust company acquiring additional investments which fulfil the 70% test and the 30% test).

(2) The condition mentioned in paragraph (1) shall be treated (in particular) as not fulfilled if—

(a) any of the money raised by the further issue (or any assets directly or indirectly derived from that money) is used for the purpose of the trust company purchasing any of its own shares, and

(b) either—

(i) the Board are of the opinion that the shares being purchased are not insignificant in relation to the issued ordinary share capital of the company, or

(ii) the purchase is made as the result of a general offer to members (with or without exceptions for persons connected with the trust company).

(3) Where the further issue of shares is of shares issued for new consideration, paragraph (1) shall be treated (in particular) as not fulfilled if—

(**20**) Paragraph 10B was inserted by section 72(2) of the Finance Act 1998.
(**21**) Section 842AA(5A) and (5B) were inserted by section 75 of the Finance Act 1997 (c. 16).

(a) any of the money raised by the further issue (or any assets directly or indirectly derived from that money) is used for the purpose of the successor company purchasing shares in any of the merging companies, or the other merging companies, as the case may be, and

(b) the money so used exceeds the least of A, B and C in regulation 9(3)(g).

(4) Where any of the money raised by the further issue (or any assets directly or indirectly derived from that money) is used for a purpose other than as mentioned in paragraph (1), section 842AA(5B) shall be treated as not having applied to the further issue from the time immediately before that use of the money or other assets.

(5) Where, in consequence of paragraph (4), the 70% test and the 30% test fall to be applied immediately before the use of money mentioned in that paragraph, the trust company's investments for the purposes of section 842AA(2)(b) and (c) shall be treated as including any money raised by that further issue (or assets directly or indirectly derived from that money).

Jim Murphy
John Heppell
Two of the Lords Commissioners of Her Majesty's Treasury

27th August 2004

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations make provision in relation to tax for the winding up of a venture capital trust, for mergers between venture capital trusts and for the tax treatment of a "further issue" of shares by any venture capital trust. Venture capital trusts ("VCTs") are companies which are approved by the Inland Revenue under section 842AA of the Income and Corporation Taxes Act 1988. The Regulations are made under powers in Schedule 33 to the Finance Act 2002. The retrospective provision made by regulation 1(2) is authorised by Paragraph 16(1)(e) of that Schedule.

Regulation 1 provides for citation, commencement and effect, and regulation 2 for interpretation.

Regulation 3 sets out details of the VCTs to which regulations 4 to 8 apply. They are companies being wound up, where the company was either (a) approved as a VCT continuously for at least 3 years ending with the winding up, or (b) approved as a VCT and being wound up compulsorily.

Regulations 4 to 8 provide that a VCT which is being wound up has a grace period (called the "prescribed winding-up period", defined by regulation 2(1) so that in most cases it will be the three years beginning at the commencement of the winding up) during which certain tax exemptions continue to apply, and provide for the VCT's tax treatment when that period expires.

Regulations 9 to 13 make provision for mergers of VCTs (as defined in Schedule 33 to the Finance Act 2002). Regulations 9 and 10 introduce a procedure for advance Inland Revenue approval of a merger (following which regulations 11 to 13 will apply to the relevant VCTs).

Regulations 11 to 13 make provision for the tax treatment of the companies involved in the merger particularly the company which represents the merged entity, known as the "successor company."

Regulation 14 makes the application of section 842AA(5B) of the Income and Corporation Taxes Act 1988 (which applies to "further issues" of shares by a VCT) conditional on the money being raised by that issue for investment purposes.

A full regulatory impact assessment has not been produced for this instrument as it has no impact (exceeding the minimum threshold) on the costs of business.